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South Carolina
Division of General Services

PROCUREMENT AUDIT AND CERTIFICATION

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AUGUST 21, 1985

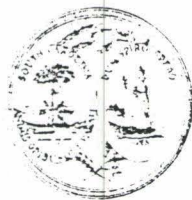
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STATE OF SOUTH CAROLINA
BUDGET AND CONTROL BOARD
DIVISION OF GENERAL SERVICES
300 GERVAIS STREET
COLUMBIA, SOUTH CAROLINA 29201
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HOUSE WAYS AND MEANS COMMITTEE

WILLIAM T. PUTMAN
EXECUTIVE DIRECTOR

August 21, 1985

Mr. Tony Ellis
Division Director
Division of General Services
300 Gervais Street
Columbia, South Carolina 29201

Dear Tony:

Attached is the final Department of Mental Health audit report and recommendations made by the Audit and Certification Office. I concur and recommend the Budget and Control Board grant the Department of Mental Health two years certification as outlined in the audit report.

Sincerely,

Richard W. Kelly, Director
Agency Certification and
Engineering Management

/db

Attachment

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WILLIAM T. PUTMAN
EXECUTIVE DIRECTOR

RICHARD W. KELLY
ASSISTANT DIVISION DIRECTOR

June 24, 1985

Mr. Richard W. Kelly
Director of Agency Certification
and Engineering Management
Columbia, South Carolina 29201

We have examined the procurement policies and procedures of the Department of Mental Health for the period of July 1, 1982 - February 28, 1985. As part of our examination, we made a study and evaluation of the system of internal control over procurement transactions to the extent we considered necessary.

The purpose of such evaluation was to establish a basis for reliance upon the system of internal control to assure adherence to the Consolidated Procurement Code and State and internal procurement policy. Additionally, the evaluation was used in determining the nature, timing and extent of other auditing procedures that were necessary for developing a recommendation for recertification above the \$2,500 limit.

The administration of the Department of Mental Health is responsible for establishing and maintaining a system of internal control over procurement transactions. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of

control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance of the integrity of the procurement process, that affected assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and are recorded properly.

Because of inherent limitations in any system of internal control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation of the system of internal control over procurement transactions as well as our overall examination of procurement policies and procedures were conducted with due professional care. They would not, however, because of the nature of audit testing, necessarily disclose all weaknesses in the system.

The examination did, however, disclose conditions enumerated in this report which we believe to be subject to correction or improvement.

Corrective action based on the recommendations described in these findings will in all material respects place the agency in compliance with the South Carolina Consolidated Procurement Code and ensuing regulations.

R. Voight Shealy

R. Voight Shealy, Director
Audit and Certification

INTRODUCTION

The Audit and Certification Section conducted an examination of the internal procurement operating procedures and policies and related manual of the Department of Mental Health.

Our on-site review was conducted March 14, 1985 through May 9, 1985, and was made under the authority as described in Section 11-35-1230(1) of the South Carolina Consolidated Procurement Code and Section 19-445.2020 of the accompanying regulations.

The examination was directed principally to determine whether, in all material respects, the procurement system's internal controls were adequate and the procurement procedures, as outlined in the Internal Procurement Operating Procedures Manual, were in compliance with the South Carolina Consolidated Procurement Code and its ensuing regulations.

Additionally, our work was directed toward assisting the agency in promoting the underlying purposes and policies of the Code as outlined in Section 11-35-20, which include:

- (1) to ensure the fair and equitable treatment of all persons who deal with the procurement system of this State;
- (2) to provide increased economy in state procurement activities and to maximize to the fullest extent practicable the purchasing values of funds of the State;

- (3) to provide safeguards for the maintenance of a procurement system of quality and integrity with clearly defined rules for ethical behavior on the part of all persons engaged in the public procurement process.

BACKGROUND

Section 11-35-1210 of the South Carolina Consolidated Procurement Code states:

The Budget and Control Board may assign differential dollar limits below which individual governmental bodies may make direct procurements not under term contracts. The materials management office shall review the respective governmental body's internal procurement operation, shall verify in writing that it is consistent with the provisions of this code and the ensuing regulations, and recommend to the board those dollar limits for the respective governmental body's procurement not under term contract.

Section 11-35-1230(1) of the South Carolina Consolidated Procurement Code states in part:

In procurement audits of governmental bodies thereafter, the auditors from the materials management office shall review the adequacy of the system's internal controls in order to ensure compliance with the requirements of this code and the ensuing regulations.

Presently, the Department is certified to conduct the following procurement activity:

<u>PROCUREMENT AREAS</u>	<u>LIMITS</u>
Goods and Services:	
A. Annual term contracts only for drugs and related pharmaceuticals defined in the State Procurements Commodity Code Manual under #270-Drugs, Pharmaceuticals and Biologicals.	\$1,600,000 Maximum of All Such Contracts Combined
B. Annual term contracts only for medical supplies under Commodity Code Classes #435-Germicides, #470-Hospital Equipment-Invalid, #475-Hospital Sundries and #465-Hospital Equipment.	\$400,000 Maximum of All Such Contracts Combined

- C. All other Goods and Services
procurements excluding printing
equipment which must be approved
by the Materials Management
Office and food commodities that
are currently combined with other
agencies' needs and procured on
scheduled buys by the Materials
Management Office.
- \$15,000 Per Purchase
Commitment

This certification is to expire July 12, 1985. Consequently,
our audit was conducted primarily for the purpose of determining
if recertification is warranted. Additionally, on March 27,
1985, the Department of Mental Health requested increased certi-
fication limits as follows:

PROCUREMENT AREAS	LIMITS
A. Annual term contracts for drugs and related pharmaceuticals, Commodity Code #270.	\$2,000,000
B. Annual term contracts for medi- cal supplies under Commodity Code	
Class #465-Hospital Equipment;	200,000
Class #435-Germicides;	200,000
Class #475-Hospital Sundries, with the exception of underpads and diapers;	300,000
Class #475-Underpads and diapers only	400,000
Delete Commodity Class #470 from the term contracts category.	
C. All other Goods and Services, excluding print equipment, con- sultant services, ITM, which must be approved by the Materials Management Office; and Food com- modities that are currently com- bined with other agencies' needs and procured on scheduled buys by the Materials Management Office; and new construction which must be approved by the State Engineer's Office.	20,000 Per Purchase Commitment (after excep- tions)

SCOPE

Our examination encompassed a detailed analysis of the internal procurement operating procedures of the Department of Mental Health and the related policies and procedures manual to the extent we deemed necessary to formulate an opinion on the adequacy of the system to properly handle procurement transactions up to the requested certification limits.

The Audit and Certification team of the Materials Management Office statistically selected random samples for the period July 1, 1983 - February 28, 1985, of procurement transactions for compliance testing and performed other auditing procedures that we considered necessary in the circumstances to formulate this opinion. As specified in the Consolidated Procurement Code and related regulations, our review of the system included, but was not limited to, the following areas:

- (1) adherence to provisions of the South Carolina Consolidated Procurement Code and accompanying regulations;
- (2) procurement staff and training;
- (3) adequate audit trails and purchase order register;
- (4) evidences of competition;
- (5) small purchase provisions and purchase order confirmations;
- (6) emergency and sole source procurements;
- (7) source selections;
- (8) file documentation of procurements;

- (9) reporting of Fiscal Accountability Act;
- (10) warehousing, inventory and disposition of surplus property;
- (11) economy and efficiency of the procurement process;
and
- (12) approval of Minority Business Enterprise Plan.

SUMMARY OF AUDIT FINDINGS

Our audit of the procurement system of the Department of Mental Health produced findings and recommendations in the following areas:

	<u>Page</u>
I. <u>SOLE SOURCE PROCUREMENTS</u>	10
Our review of the quarterly reports of sole source and emergency procurements revealed the majority of these transaction to be proper and accurately reported with only two exceptions noted.	
II. <u>COMPLIANCE - GOODS AND SERVICES</u>	12
We noted two instances where orders were split in order to circumvent the Procurement Code.	
III. <u>COMPLIANCE - INFORMATION TECHNOLOGY</u>	15
In our review of sixty randomly selected transactions in the information technology area, we found four exceptions.	
IV. <u>COMPLIANCE - CONSTRUCTION</u>	18
In one instance, architect-engineering firms were not notified of their ranking, as required by Section 11-35-3220(6) of the Procurement Code.	
V. <u>REVIEW OF THE PROCUREMENT PROCEDURES MANUAL</u>	19
Our review indicated areas that need to be added, changed or updated.	

RESULTS OF EXAMINATION

I. SOLE SOURCE PROCUREMENTS

We examined the quarterly reports of sole source and emergency procurements and trade-in sales and all available supporting documents for the period July 1, 1982 - December 31, 1984, to determine the appropriateness of the procurement actions taken and the accuracy of the reports submitted to the Division of General Services, as required by Section 11-35-2440 of the Consolidated Procurement Code. We found these transactions to be proper and accurately reported with the following two exceptions:

<u>P.O. Number</u>	<u>Amount</u>	<u>EXCEPTION</u>
13572	\$3,246.00	This sole source procurement was for one Micro-Design DC 58-AE Reader/Printer and six Eye Com Readers. Micro-Design is an open product line so bids should have been solicited.

Section 19-445.2105, Subsection B, of the regulations states in part:

Sole source procurement is not permissible unless there is only a single supplier...

The Materials Management Officer has interpreted this as follows:

The terminology 'only one source' is intended to mean one manufacturer or unique service provider distributing through one distributor channel. If a firm specification for a product or service is requested due to a unique circumstance or need only satisfied by the procurement of that specific product/service and there is more than one source of dis-

tribution, the procurement is not sole source. Bids should be forwarded to all known distributors to achieve the lowest possible price for the particular service or product.

Purchase order number 21851 was for Xerox copier model 1048. After conversation with State Procurements, the agency determined the source selection process for the copier to be sole source. The State Information Technology Management Officer, in a memo to all purchasing and data processing directors dated April 24, 1984, stated that all requests for copiers, regardless of cost, must be sent to the Materials Management Office for processing and addition to the State inventory.

An exception to the process has been allowed for sole source procurement where the agency issues their own purchase order. However, the Purchasing Office should submit a copy of the purchase order and any future sole source copier procurement to the Information Technology Management Office so the equipment can be added to the State inventory.

RESPONSE

1. A Sole Source Determination was reached on P.O. No. 13572 because on two previous occasions, bids were solicited for this item with only one vendor's response for the specified item. Solicitation was not deemed practical for this third procurement as we felt the first two transactions had tested the market adequately for the Micro-Design DC 58-AE Reader/Printer and six Eye Com Readers, therefore, a sole source justification (Form MM102) was prepared.

2. A copy of P.O. No. 21851 for the purchase of one Xerox Model 1048 was forwarded to the Materials Management Office on May 17, 1985, for addition to the State inventory system. Future transactions for copiers will be properly processed.

II. COMPLIANCE - GOODS AND SERVICES

During our review of goods and services transactions, we found three cases where Department clinics and centers exceeded their delegated procurement limit of \$2,500.00. In two cases, orders were artificially divided to constitute small purchases and in the third instance an order totaling \$3,446.10 was placed without approval from the Purchasing Office.

A children's treatment home used the Department's Order-Invoice-Acknowledgement (F11-A) procurement method to bypass the Purchasing Office. The home made a procurement of \$7,468.75 of furniture after obtaining informal quotations. Although the quotations obviously were for one order and were opened on the same day, August 30, 1984, the order was spread over the following five F11-A's to the same vendor:

<u>F11-A Number</u>	<u>AMOUNT</u>
09761	\$1,123.13
09762	450.45
09763	2,294.25
09764	2,139.90
09765	1,461.02
Total	<u>\$7,468.75</u>

A similar situation was noted at the Aiken-Barnwell Mental Health Center where two different requests for quotations totaling \$4,451.20 were opened January 25, 1985. Since these requests for quotations were for similar items they should have been combined and sent to the Purchasing Office for processing.

Section 19-445.2100, Subsection A, of the regulations states in part: "Any procurement not exceeding \$2,499.99 may be made by governmental bodies provided, however, that procurement requirements shall not be artificially divided...so as to constitute a small purchase under this Subsection."

Finally, the same children's home mentioned above procured major appliances totaling \$3,446.10. Informal quotations were received but formal solicitation procedures were not used.

All of these procurements are in violation of Section 11-35-1520 of the Procurement Code which states: "Contracts amounting to two thousand, five hundred dollars or more, shall be awarded by competitive sealed bidding...." Further, Section 19-445.2100, Subsection A, of the regulations, states in part: "Any procurement not exceeding \$2,499.99 may be made by governmental bodies provided, however, that procurement requirements shall not be artificially divided...so as to constitute a small purchase under this Subsection." Finally, Department policy indicates that procurements greater than \$2,500.00 must be processed by the Purchasing Office.

Since these procurements were made by satellite offices without proper requisite authority, they must be considered unauthorized and in violation of Section 19-445.2015, Subsection A, of

the regulations. They are all within the Department of Mental Health's procurement certification so they must be ratified by the State Commissioner.

These exceptions indicate that area offices are unsure of their procurement authority restrictions. Specifically, they seem to feel the authority limit is based on the dollar amounts of contracts or vouchers submitted for payment. This is not the case. The authority limits apply to the total solicitation, not individual awards. The Department should clarify procurement restrictions placed on area offices through a memorandum that would address splitting of orders and unauthorized procurements.

These exceptions also indicate a weakness in control over the Department's F11-A's in that they were not stopped by the Office of Finance. F11-A's from satellite offices are not reviewed by the Purchasing Office so they must be monitored carefully by Finance to ensure that exceptions are eliminated.

RESPONSE

1. We acknowledge that Vouchers No. 9761 through 09765 represent purchases that were not made in compliance with the Procurement Code. The Procurement officer of the offending Center has been notified of the violations and has been requested to take steps to avoid repeat violations.

2. Voucher Nos. 30595 and 37017, which further attempted to circumvent the Code in the procurement of furniture and appliances for Children's Home and Aiken-Barnwell Mental Health Center are acknowledged. The violations have been brought to the

attention of the Center Procurement Officers, who will monitor their procurement practices to avoid this violation in the future.

3. Voucher No. 13114 was for the purchase of appliances without following proper bidding procedures. This violation has been called to the attention of the offending Center. Procurement personnel have given us their assurance that steps are being taken to correct bidding procedures.

III. COMPLIANCE - INFORMATION TECHNOLOGY

In our test of sixty transactions in the area of information technology, we found the following exceptions:

	<u>Voucher Number</u>	<u>Voucher Date</u>	<u>Amount</u>
(1)	00142	07/19/83	\$4,224.00
(2)	09163	10/08/84	690.00
(3)	02584	08/13/84	731.00
(4)	00240	07/30/83	2,498.00

Item (1) was from the Orangeburg County Mental Health Center for maintenance on an information processor. This transaction was paid by an F11-A that was supported by neither evidence of competition nor a sole source justification.

Item (2) was for a service/maintenance contract established in July, 1984, for a copier by the Piedmont Mental Health Center. Again, payment was made by F11-A without solicitation of competition or preparation of a sole source justification. The Mental Health Purchasing Director has taken steps to remedy this violation.

Item (3) was for the procurement of developer and toner for a copier which the Aiken-Barnwell Mental Health Center bought directly. Competition was not solicited as required by the Procurement Code.

As was the case in II above, exceptions (1)-(3) are from direct expenditure (F11-A) transactions that were processed by Mental Health Centers under their delegated authority limit of \$2,500.

Item (4) was for payment on a maintenance contract for controllers and disk drives. This contract continues to be "rolled over" from year to year without soliciting new proposals. The last maintenance contract was signed in January, 1981, with no specified term.

Section 17 of the Appropriations Act for Fiscal Year 1983-84 requires the following:

Any contract entered into prior to July 30, 1981, by a governmental body as defined in Item (18) of Section 11-35-310 of the 1976 Code and which is proposed to be renewed must be renewed in accordance with the provisions of the South Carolina Consolidated Procurement Code (Chapter 35 of Title 11 of the 1976 Code).

This means that contracts established before the enactment of the Procurement Code cannot be renewed or "rolled-over" unless they meet the above criteria. If renewal is required for an existing contract that was not procured under the Procurement Code, the renewal must be done in accordance with the Code, i.e., the renewal is a new procurement.

Furthermore, the equipment requiring this maintenance is a very old system with a current yearly maintenance cost exceeding \$36,000. We feel an evaluation of this system should be done to determine if it would be feasible to replace the system. The State Information Technology Officer should be contacted for his opinion and suggestions on updating the current system and what options are available.

RESPONSE

1. A sole source justification form will be executed to cover the transaction processed on Voucher No. 00142.

2. Steps have been taken to remedy the violation which occurred on Voucher No. 09163 and this is noted in the audit report.

3. Violations represented by the transaction reported on Voucher No. 2584 have been identified and steps are being taken to prevent violations by this Center on future procurements.

4. Voucher No. 00240 dated July 30, 1983, in the amount of \$2,498.00 was paid to National Advanced Systems (NAS) for a maintenance contract for controllers and disk drives. According to Mr. Harold Stewart of the ITM Office, no other company will maintain NAS's disk drives. Accordingly, a sole source declaration was prepared on April 2, 1985. We have requested funds to replace this equipment during FY 86/87.

IV. COMPLIANCE - CONSTRUCTION

During a review of construction procurements and the related files, we noted one instance where the architect- engineering firms who responded to a solicitation were not notified of their ranking order. Architectural firms were selected and ranked for furnishing consultant services to provide selection, layout, specifications and supervision of all equipment for the Patrick B. Harris Psychiatric Hospital. After selection approval from the State Engineer, the responding firms were not notified of their ranking order as required by Section 11-35-3220(6) of the Procurement Code.

In future selections, the Office of Physical Plant Services must insure all firms are notified as to the award and order of preference of the agency's selection committee.

RESPONSE

1. We acknowledge that notification was not made to the architectural firms who responded to our solicitation for the Patrick B. Harris Psychiatric Hospital. Our office of Physical Plant Services has been advised of this oversight, and has responded that steps have been taken to insure that henceforth, notification will be sent to all firms as to the award and order of preference of the Agency's selection committee.

V. REVIEW OF THE PROCUREMENT PROCEDURES MANUAL

We reviewed the Procurement Procedures Manual to determine if any changes made since the agency was previously certified have been documented.

We found the following sections need to be added, changed or expanded:

<u>Policy Number</u>	<u>COMMENT</u>
16.301	Add to the last paragraph that "The Community Mental Health Centers and Clinic's payment vehicle for purchases will be the direct expenditure voucher, Mental Health's form F11-A." Also, this section should indicate that F11-A's from centers and clinics are not monitored by the Purchasing Office so administrators are held accountable for procurements made by this method.
16.401	Under Item #5 change "Director of Purchasing" to read "Chief Procurement Officer" (reference Regulation 19-445.2030(4)).
16.19	In the fourth sentence after the words "may protest", add "to the appropriate Chief Procurement Officer."
16.20	The sentence "All F11-A's are to be routed through Purchasing for approval, ..." should be deleted since this does not apply to the Mental Health Centers and Clinics any longer.
16.20	Since some sole source procurements are currently being paid by F11-A voucher, this should be added to the list on Section 16.20, page 2.

RESPONSE

1. The internal Procurement Policies and Procedures Manual will be revised as recommended and will also include other updates as deemed appropriate. Projected completion date of this revision is September 15, 1985.

CERTIFICATION RECOMMENDATIONS

As enumerated in our transmittal letter, corrective action based on the recommendations in the body of this report, we believe, will in all material respects place the Department of Mental Health in compliance with the State Consolidated Procurement Code and ensuing regulations.

In accordance with Code Section 11-35-1230(1), the Department should take this corrective action prior to September 30, 1985, the end of the next subsequent quarter.

The major procurement area that requires corrective action is the use of Order-Invoice-Acknowledgements (F11-A's). We realize the Department has a need for a direct expenditure procedure, but in our opinion, this procurement method has been misused as noted in points II and III of this report.

Based on these exceptions, it is evident that either controls over F11-A transactions must be strengthened or delegated procurement authority must be limited. We recommend that, as a minimum, Finance Department personnel be advised of the restrictions on F11-A transactions. Further, we recommend that the Internal Audit Department perform periodic spot checks of F11-A transactions.

The Audit and Certification Section will perform a follow-up review to determine if the proposed corrective action has been taken by the Department. Based on the follow-up review, and subject to this corrective action, we will recommend that the

Department of Mental Health be recertified to make direct agency procurements for a period of two years as follows:

PROCUREMENT AREAS	RECOMMENDED CERTIFICATION LIMITS
(A) Agency term contracts for drugs and related pharmaceuticals, Commodity Code #270	*\$2,000,000 maximum of all such contracts combined
(B) Agency term contracts for medical supplies under Commodity Code Class #465 - Hospital Equipment;	*\$200,000 maximum of all such contracts combined
Commodity Code Class #435 - Germicides;	*\$200,000 maximum of all such contracts combined
Commodity Code Class #475 - Hospital Sundries with the exception of underpads and diapers;	*\$300,000 maximum of all such contracts combined
Commodity Code Class #475 - Underpads and diapers only.	*\$400,000 maximum of all such contracts combined
(C) All other Goods and Services, excluding printing equipment which must be approved by the Division of Information Resource Management.	*\$20,000 per purchase commitment

*This limit means the total potential contractual obligation to the State whether single year or multi-year contracts are utilized.

This would result in the Department of Mental Health handling 99% of their procurement transactions in these areas.

Certification in the areas of Information Technology, Construction and Consultant Services are not being addressed in this report because the Department did not request to be certified over \$2,500 in these areas. Our examination, however, included a review of these areas for compliance as required by the Code.

RESPONSE

We appreciate your recognition that we have a need for a direct expenditure voucher system, and plan to take steps to insure that future abuses of this system do not occur.

Our Procurement Office, with the cooperation of the Accounts Payable staff, plans to conduct a seminar outlining restrictions governing the use of F-11a's by Center procurement personnel and authorized Departmental personnel. This will enable us to identify and solve problem areas before they have compounded unnecessarily.

We have stated earlier, (See Section II. Compliance - Goods and Services) that Center Procurement Personnel will be given a review of procedures to be followed in making procurements within their limit of \$2,499.99, so that they may be in compliance with the Code.

Our Division of Internal Audit has responded to your recommendation that they perform spot checks of F-11a transactions, and plan to do a test of nothing but F-11a's during the month of February, 1986. They state further, that they will be testing F-11a transactions through FY 86 as they audit the various Mental Health Centers. We are assured of their total involvement in all areas in which exceptions were found during your audit of our facility for the period of July 1, 1982, through February 28, 1985.

James M. Stiles
James M. Stiles, PPB
Audit Supervisor

R. Voight Shealy
R. Voight Shealy, Director
Audit and Certification

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WILLIAM T. PUTMAN
EXECUTIVE DIRECTOR

August 21, 1985

Mr. Richard W. Kelly
Director of Agency Certification
and Engineering Management
Division of General Services
300 Gervais Street
Columbia, South Carolina 29201

Dear Rick:

We have returned to the Department of Mental Health to determine the progress made toward implementing the recommendations in our audit report covering the period July 1, 1982 through February 28, 1985. During this visit, we followed up on each recommendation made in the audit report through inquiry, observation and limited testing.

The Office of Audit and Certification observed that the Department of Mental Health has made substantial progress toward correcting the problem areas found and improving the internal controls over the procurement system. We feel that with the changes made, the system's internal controls should be adequate to ensure that procurements are handled in compliance with the Consolidated Procurement Code and ensuing regulations.

We therefore recommend, that the certification limits as outlined in the audit report be granted for a period of two (2) years.

Sincerely,

A handwritten signature in dark ink that reads "R. Voight Shealy".

R. Voight Shealy, Director
Audit and Certification

/db

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